

## Agricultural Economy



Jack Harrison

### Farm Credit Use to Expand Moderately in 2002

**C**redit plays an important role in helping U.S. farm operators acquire the assets they need to compete in a capital-intensive industry experiencing rapid advances in technology. In 2001, U.S. farmers owed \$192.8 billion in farm loans, an amount that has been growing since 1992 and is expected to increase again in 2002. Low farm prices for several key commodities in recent years and uncertainties about future levels of direct government payments have created some concerns regarding farmers' continued access to adequate credit and the willingness of credit suppliers to meet their needs.

Total farm business debt in 2002 is forecast to rise by \$3.7 billion—or just 1.9 percent—to \$196.5 billion. This will be the 10th consecutive annual increase, but represents the smallest annual growth since debt dipped slightly in 1992. With limited or no gains in farm prices expected this year following relatively low levels in 2001, farmers may be more cautious about adding new debt. Also, the farm sector and its lenders learned from the farm financial crisis of the 1980s that borrowing does not substitute for adequate cash flow and profits.

Slower debt growth partially reflects moderate levels of expected new capital investments. Also, adequate levels of working capital and sizable off-farm earnings are expected to help farmers hold down new borrowing.

High levels of direct government payments to farmers (including payments under five emergency assistance programs between October 1998 and August 2001) are also moderating demand for credit and helping to maintain farmland values. Farmers collectively received an average of \$17.7 billion per year in direct payments for 1998-2002, up from \$8.8 billion per year for the 1990-97 period. Many farmers have been maintaining or improving their balance sheets by avoiding new debt or by applying some of their government payments to reducing existing debt.

There are some dark clouds, however. Continued low prices for several key agricultural commodities, coupled with weather problems in some regions, may diminish the ability of less creditworthy farmers to continue securing or retaining loans, especially production credit.

Thanks to sizable government assistance, net cash income (which measures cash

available from sales after paying cash operating costs) is estimated at \$59.5 billion for 2001, the highest on record. But in 2002—assuming no new farm bill or additional emergency assistance—direct farm payments are projected to drop from 2001 levels and farm lenders will be dealing with a farm sector whose net cash income could decline 14 percent to \$50.9 billion. In that case, the reduction in net cash income and continuing narrow margins in 2002 would force more farmers to manage relatively tight cash flows.

Farm-sector equity by the end of the year is expected to be some \$7.8 billion more than in 2001. But the projected drop in net cash income—assuming no new farm bill or additional emergency assistance—would reduce farmers' credit reserves and expose a larger share of farms to potential debt repayment problems.

### *Growth in Nonreal-Estate Debt May Outpace Mortgage Debt*

Farm nonreal-estate debt is forecast to rise marginally faster than farm mortgage debt in 2002. This differs from 2001 when farm real-estate loan balances increased 5.7 percent compared with 3.8 percent for nonreal-estate debt. The recent more rapid growth in real-estate debt, relative to loans for nonreal-estate purposes, is at least partially due to more lenders requiring farmland as collateral for nonreal-estate loans. Loans to purchase machinery and seasonal production inputs may be reported as loans secured by farmland, and are counted as farm mortgage loans.

**Nonreal-estate business loans** to farmers are forecast to increase about 2.4 percent in 2002 to \$91.9 billion. Total planted acres for the eight principal field crops (corn, sorghum, barley, oats, wheat, rice, upland cotton, and soybeans) in 2002 are forecast to be 248.3 million acres. Even with some acreage shifts among crops, and lower input prices, total production expenses in 2002 are forecast at \$200 billion, up 0.3 percent from 2001. Because of lower input prices, expenditures for seeds, fertilizer, and agricultural chemi-

As of this writing, House and Senate farm bill conferees were still working out the language of the legislation.

cals are forecast at \$27 billion, down from \$27.4 billion in 2001. Farm-sector fuel expenses declined from \$7.2 billion in 2000 to \$6.7 billion in 2001, and were expected to edge down in 2002 until the current uncertainty entered the oil market.

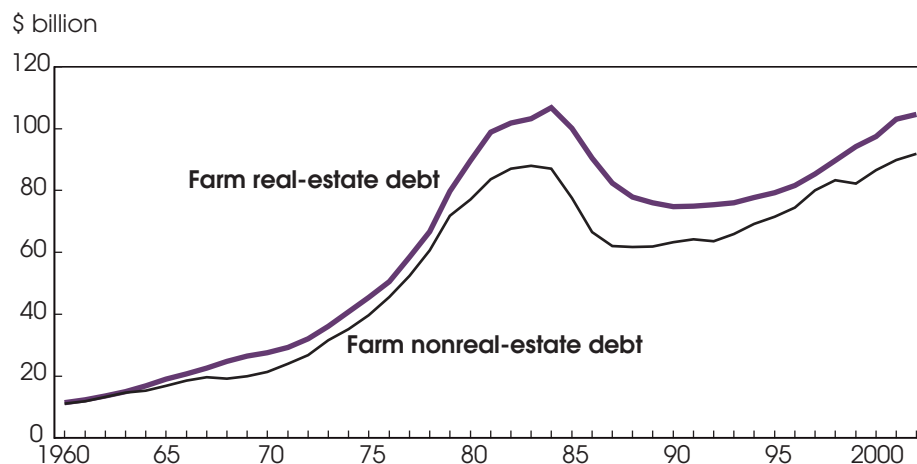
Unit sales of farm tractors, combines, and other farm machinery in 2001 were up from a year earlier, but have not recovered from the farm sector's economic slowdown that began in 1998. In 2001, sales of large two-wheel-drive tractors (100-horsepower and over) were down 29 percent, and those of four-wheel-drive tractors were down 43 percent from their highs in 1997. Sales of combines were down 38 percent from the 1998 high. For 2002, the Association of Equipment Manufacturers (AEM) projects a 3.4-percent decline for two-wheel-drive tractors, a 0.7-percent drop for four-wheel-drive tractors, and a 6-percent decrease for self-propelled combines. In contrast, AEM projects increases in 2002 for 10 of the 15 equipment categories other than tractors and combines.

On balance, sluggish sales for "big-ticket items" such as tractors and combines are likely to overshadow or at least partially offset sales strength for other machinery lines in 2002 and moderate demand for short- and intermediate-term farm loans. A larger share of big-ticket items is now financed by subsidiaries of machinery companies rather than by the more traditional institutional lenders.

Farm business interest expenses are projected to decrease about 3.4 percent in 2002 to \$14.1 billion. While farm business debt is forecast to increase in 2002, interest rate reductions in 2001 by the Federal Reserve suggest interest rates on farm credit—because of a lag—will average lower in 2002, particularly for shorter term loans.

**Farm real-estate loans** are forecast to increase 1.5 percent to \$104.6 billion in 2002. Mortgage loan volume is generally affected by changes in farmland values. Total U.S. farmland value, as reported in USDA's farm-sector balance sheet, increased an estimated 3 percent in 2001 and is expected to advance about 1.2

### Farm Real-Estate Debt Continues to Trend Upward



2001 preliminary; 2002 forecast.

Economic Research Service, USDA

percent in 2002. This would be the 16th consecutive annual increase since 1987, though the recent rate of increase has slowed. The outlook for 2002 could be tempered if new farm legislation does not provide additional direct payments to bring total farm spending more in line with recent years.

While recent farmland value growth rates are down, they have been buoyed in many areas by direct government payments, off-farm employment, and urban sprawl (expansion of urban areas and large-lot development in rural areas). During 1992-2000, the yearly gains, averaging 5.6 percent, were the highest since values began to recover in 1987.

Recent gains in farmland value may not have led to corresponding increases in demand for farm mortgage credit. A significant portion of the price gain may have been driven by urban sprawl and nonfarm investors rather than by farmers. Moreover, many of the farmer buyers reportedly were able to pay wholly or in large part with cash and not via borrowing. For many midsize to smaller farms, strong off-farm earnings in recent years have allowed operators to bid higher on farmland tracts than agricultural-use values would indicate.

### Will the Credit Supply Be Adequate?

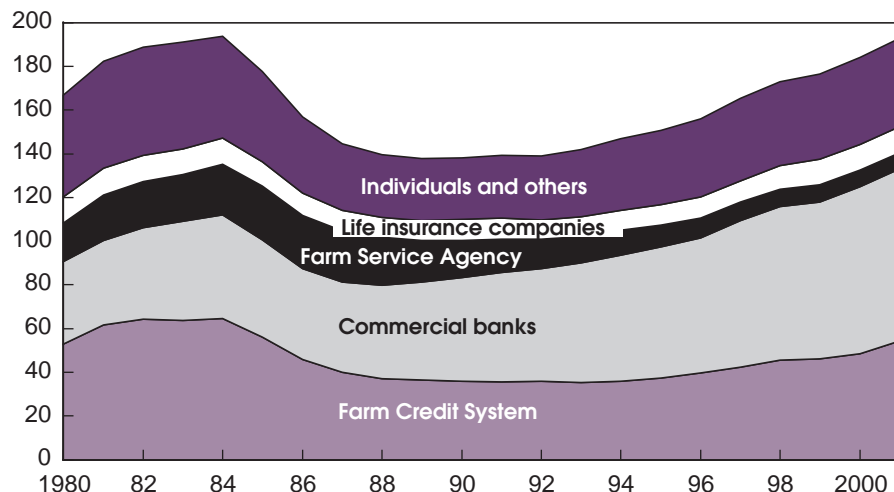
The financial position of commercial agricultural lenders in 2002 is generally healthy. Farm lending institutions continue to build capital and maintain favorable credit quality levels in their loan portfolios. All major lender categories continue to experience low levels of delinquencies, foreclosures, loan chargeoffs, and loan restructuring. Farm financial stress, unless sustained, should not significantly affect aggregate loan delinquency rates or other farm lender indicators. The duration of relative price weakness for several major farm commodities is unknown, but the data indicate no significant problems in national lender performance to date.

The four traditional categories of institutional farm lenders, in order of overall farm credit volume, are **commercial banks**, the **Farm Credit System** or **FCS** (a collection of federally-chartered, borrower-owned credit cooperatives that lend primarily to agriculture), **life insurance companies**, and USDA's **Farm Service Agency** or **FSA** (the government "farm lender of last resort"). Together, these four classes of lenders accounted for 79 percent of all farm loans outstanding in 2001. The remaining share of farm credit comes from individuals and from nontraditional lenders, primarily input and machinery suppliers, cooperatives, and processors.

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### Total Farm Business Debt Has Risen Since 1989, with Commercial Banks Holding an Increasing Share

\$ billion



2001 preliminary.

Economic Research Service, USDA

In 2001, total farm business debt grew 4.8 percent, and outstanding loan volume increased for all farm lenders except FSA. FCS, second to commercial banks and having the fastest growth in loan volume, accounted for two thirds of the growth in total debt last year. Outstanding farm business loans at the FCS grew 12.1 percent to \$54.4 billion, followed by commercial banks (2.9-percent growth to \$78.6 billion) and life insurance companies (1.5-percent growth to \$12 billion). In contrast, FSA's total farm business direct loans outstanding decreased 2.5 percent in 2001 to \$7.3 billion.

Availability of funds is not a major concern for creditworthy borrowers since most lenders have access to more money than they can profitably lend. Farm loan interest rates in 2002, while expected to increase moderately during the year, should remain low by historical standards, and this will help farmers carry debt. As always, agricultural lenders will closely examine the profit margin of farmers' operations when making loan decisions. Borrowers who cannot show repayment ability even with the substantial government assistance of recent years may have to curtail operations, restructure, or exit farming.

**Commercial banks** show a recent growth in farm loan demand in agricultural areas as reflected in their loan-to-deposit ratios. In the past, the liquidity position of these agricultural banks was closely watched because of their dominant role in providing farm loans. Average loan-to-deposit ratios for agricultural banks were 76.5 at the end of the third quarter of 2001 (latest available data). They appear to have reached a plateau since mid-2000 when they stood at 76 percent compared with 72 at the beginning of the year. Ten years earlier, the ratio was 56 percent.

In the past, high loan-to-deposit ratios might have constrained new loan originations, but commercial banks now have nondeposit sources of funds such as the Federal Home Loan Bank System, and may sell farm mortgage loans to Farmer Mac. The recent jump in loan-to-deposit ratios may indicate greater reliance on these funding sources, plus sluggish growth in deposits. Profitable, well-managed agricultural banks often have very high loan-to-deposit ratios. Although banks in rural areas make considerably less use of nondeposit funds than metropolitan banks, most still use these funds to some extent.

Overall, adequate funds are available from banks for agricultural loans, with few banks reporting a shortage of loanable funds. Commercial bank farm loans are projected to increase 2.3 percent in 2002, compared with 2.9 percent in 2001.

The **Farm Credit System (FCS)** is in excellent financial condition and well positioned to supply farmers' credit needs in 2002. In recent years, the FCS has undergone massive restructuring of its organization and procedures. FCS has gained farm loan market share in 6 of the past 7 years after a gradual loss in 9 of the 10 previous years. Government backing allows the FCS to access national money markets and provide credit at very competitive rates.

In 2002, FCS farm business debt is forecast to increase 2.1 percent following a 12.1-percent rise in 2001. The mortgage debt portion is expected to increase about 1.6 percent in 2002, and the nonreal estate portion about 3 percent.

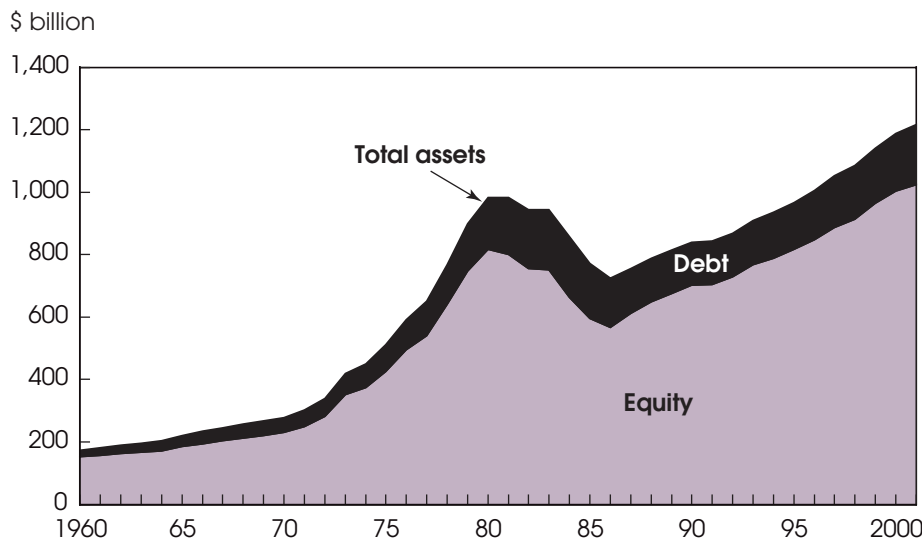
**Farm Service Agency (FSA)** loans serve farmers unable to obtain credit elsewhere. Based on loan activity from the first 6 months of fiscal year 2002, FSA should have sufficient lending authority to meet most program demand during the balance of the year. Lending authority of \$4.4 billion was available at the start of the fiscal year, compared with \$3.3 billion in actual lending during fiscal 2001. For fiscal 2003, the President's budget calls for \$3.7 billion in lending authority. FSA can also provide emergency credit after the occurrence of natural disasters.

**Life insurance companies** report adequate funds for loans that meet their quality standards. Farm lending activity by life insurance companies is forecast up 1.6 percent in 2002, compared with a 1.5-percent increase in 2001. Since 1992, life insurance industry holdings of farm mortgages have increased each year for a total gain of 36.7 percent.

In the coming months, lenders will likely remain cautious in extending agricultural credit, due largely to uncertainty about farm commodity prices and the level of government payments. Lenders were able to manage most farm loan repayment problems last year, given relatively

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## Farmers' Equity Has Been Above Previous High Since 1997



2001 preliminary.

Economic Research Service, USDA

healthy recent farm incomes bolstered by the additional Federal financial assistance.

Any deterioration in lenders' portfolios due to the 2002 farm financial situation is likely to be manageable. But, if low commodity prices persist and Federal assistance to farmers declines, lenders would increasingly face renewal requests for substandard loans and see a deterioration in customer creditworthiness. In this scenario, some farmers would need to reconsider and reformulate their plans to use additional loans to finance operations.

Today, despite relatively low prices, lenders appear confident about the bulk of their farm customers, given the level of Federal financial assistance provided to

farmers. Although farm debt has risen in recent years, most farmers are not as heavily leveraged as a decade ago. Veteran lenders cite significant differences from the 1980s, including lower interest rates, more owner equity, better credit analysis and monitoring methods, strong off-farm incomes, and improved management ability of their producer customers.

**AO**

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## May Releases—National Agricultural Statistics Service

The following reports are issued electronically at 3 p.m. (ET) unless otherwise indicated.

[www.ers.usda.gov/nass/pubs/pubs.htm](http://www.ers.usda.gov/nass/pubs/pubs.htm)

## May

- 1 Crop Progress (4 p.m.)
- 2 Weather - Crop Summary (noon)
- 3 Broiler Hatchery Egg Products
- 5 Dairy Products Prices (8:30 a.m.)  
Dairy Products  
Poultry Slaughter  
Poultry Slaughter - Annual  
Vegetables
- 8 Crop Progress (4 p.m.)
- 9 Weather - Crop Summary (noon)
- 10 Crop Production (8:30 p.m.)  
Broiler Hatchery
- 12 Dairy Products Prices (8:30 a.m.)  
Milkfat Prices (8:30 a.m.)  
Turkey Hatchery
- 15 Potato Stocks  
Crop Progress (4 p.m.)
- 16 Weather - Crop Summary (noon)
- 17 Broiler Hatchery  
Milk Production
- 18 Hatchery Production - Annual
- 19 Dairy Products Prices (8:30 a.m.)  
Cattle on Feed  
Cold Storage  
Livestock Slaughter
- 22 Catfish Processing  
Crop Progress (4 p.m.)
- 23 Weather - Crop Summary (noon)  
Chickens and Eggs  
Monthly Agnews
- 24 Broiler Hatchery
- 25 Dairy Products - Annual  
Floriculture Crops  
Milk - PDI
- 26 Dairy Products Prices (8:30 a.m.)  
Milkfat Prices (8:30 a.m.)  
Meat Animals - PDI  
Monthly Hogs and Pigs  
Peanut Stocks and Processing
- 29 Poultry - Production and Value  
Crop Progress (4 p.m.)
- 30 Weather - Crop Summary (noon)  
Agricultural Prices

## For more information:

Demand for farm credit and the farm lender situation are discussed further in the latest issue of *Agricultural Income and Finance* at [www.ers.usda.gov/publications/so/view.asp?f=economics/ais-bb/](http://www.ers.usda.gov/publications/so/view.asp?f=economics/ais-bb/)

Factors affecting farmland values are discussed in *Agricultural Outlook* October 2000 and August and November 2001, at [www.ers.usda.gov/publications/AgOutlook/Archives/](http://www.ers.usda.gov/publications/AgOutlook/Archives/)